Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

Antonio C. Mastrobuono and Diana G. Mastrobuono,

Petitioners,

v.

Shearson Lehman Hutton Inc., a corporation, Nick DiMinico, Richard F. Benzer, and Mark Stevenson,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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86 pp

QUESTIONS PRESENTED

1. Whether the Seventh Circuit erred in holding, contrary to the rulings of the First, Eighth, Ninth and Eleventh Circuits, that the law of a state named in a choice of law provision, rather than the Federal Arbitration Act, governs the arbitrability of a claim for punitive damages arising out of a contract which evidences a transaction involving commerce and which contains a comprehensive arbitration clause.

2. Whether the Seventh Circuit erred in holding, contrary to the precedent of this Court and the Eleventh Circuit, that a party to a contract waives the right to recover punitive damages by entering into a contract which provides that the agreement is governed by the law of a state which does not permit arbitral

awards of punitive damages and a comprehensive arbitration clause.

TABLE OF CONTENTS

Page

Questions Presented i

Table Of Contents iii

Table Of Authorities v

Citations To Opinions Below 2

Statement Of Jurisdiction 3

Statute Involved 3

Statement Of The Case 5

Reasons For Allowance Of The Writ . . 10

I. THE SEVENTH CIRCUIT'S INCORRECT DETERMINATION THAT THE LAW OF A STATE NAMED IN A CHOICE OF LAW PROVISION, RATHER THAN THE FAA, DETERMINES WHETHER AN ARBITRATOR HAS THE AUTHORITY TO AWARD PUNITIVE DAMAGES, CONFLICTS WITH THE DECISIONS OF THE FIRST, EIGHTH, NINTH AND ELEVENTH CIRCUITS ON THE SAME MATTER, CONTRAVENES THE POLICIES UNDERLYING THE FAA AND MISAPPLIES THE DECISIONS OF THIS COURT 15

A. The Seventh Circuit's Decision In This Case Directly Conflicts With The Decisions Of The First, Eighth, Ninth And Eleventh Circuits And Deepens The Split Of Authority Among The Circuits On The Issue Presented 15

B. The Seventh Circuit's Decision In This Case Contravenes The Provisions Of The FAA And The Policies Underlying That Act 28

II. THE SEVENTH CIRCUIT INCORRECTLY RULED THAT, BY AGREEING TO A COMPREHENSIVE ARBITRATION CLAUSE AND TO THE SELECTION OF A FORUM IN A CHOICE OF LAW CLAUSE WHICH DOES NOT PERMIT PUNITIVE DAMAGES, PETITIONERS WAIVED THEIR RIGHTS TO RECOVER PUNITIVE DAMAGES 32

Conclusion 35

TABLE OF AUTHORITIES

CASES **Page**

Barbier v. Shearson Lehman Hutton Inc., 948 F.2d 117 (2nd Cir. 1991) 17, 28

Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir. 1988) 18, 23, 25, 33

Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985) . . 11, 29

Fahnestock & Co., Inc., v. Waltman, 935 F.2d 512 (2nd Cir. 1991) 17

Garrity v. Stuart, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976) . . 14, 15-16, 26, 28, 29, 30, 31

Johnson v. Zerbst, 304 U.S. 458, 58 S.Ct. 1019, 82 L.Ed. 1461 (1938) 33

Lee v. Chica, 983 F.2d 883 (8th Cir. 1993), *cert. denied*, __ U.S. __, 114 S.Ct. 287, 126 L.Ed.2d 237 (1993) . . . 18, 21, 22

Mastrobuono v. Shearson Lehman Hutton Inc., 20 F.3d 713 (7th Cir. 1994) 9, 17, 26, 32

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985) 19-20

Moses H. Cone Hospital v. Mercury Construction Corp., 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983) 11, 24

Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6, (1st Cir. 1989) 17-18, 19, 20

Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991) 18, 22, 23

Volt Info. Sciences, Inc. v. Board of Trustees, 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989) 11, 12, 14, 16-17, 20, 21, 23, 27

Willoughby Roofing & Supply Co. v. Kajima International, Inc., 598 F.Supp. 353, *affirmed*, 776 F.2d 269 (11th Cir. 1985) . 24, 25

STATUTES

9 U.S.C. §2 3

9 U.S.C. §10(a) 4, 9

28 U.S.C. §1254(1) 3

28 U.S.C. §1331 7

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1994

Antonio C. Mastrobuono and
Diana G. Mastrobuono,
Petitioners,

v.

SHEARSON LEHMAN HUTTON INC.,
Nick DiMinico, Richard F. Benzer, and
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Petition for Writ of Certiorari to the
United States Court of Appeals
For the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

Petitioners, Antonio C. Mastrobuono and Diana G. Mastrobuono (hereinafter "petitioners") respectfully pray that a writ of certiorari issue to review the

judgment and opinion of the United States Court of Appeals for the Seventh Circuit, entered in this cause on March 30, 1994.[1]

CITATIONS TO OPINIONS BELOW

The decision of the Court of Appeals for the Seventh Circuit (hereinafter the "Seventh Circuit") is reported at 20 F.3d 713 (1994), and is reprinted in full in the appendix hereto at App. 1 - App. 27.

The order of the United States District Court for the Northern District of Illinois, Eastern Division (C. Norgle) is reported at 812 F.Supp. 845 (N.D. Ill. 1993), and is reprinted in full in the appendix hereto at App. 28 - App. 43.

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[1] Counsel for petitioners wish to acknowledge the assistance in the preparation of this Petition For Writ Of Certiorari of law student Ricky G. Olcyzk.

STATEMENT OF JURISDICTION

Petitioners seek review of the decision of the Seventh Circuit entered on March 30, 1994, affirming the District Court's order vacating the arbitrators' award of punitive damages in favor of petitioners and denying petitioners' motion, in the alternative, for a trial on petitioners' punitive damages claims.

Jurisdiction is conferred upon this Court to review the March 30, 1994 judgment of the Seventh Circuit by 28 U.S.C. §1254(1).

STATUTE INVOLVED

9 U.S.C. §2 provides:

> **Validity, irrevocability, and enforcement of agreements to arbitrate.**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the

whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. §10(a) provides:

Award of Arbitrators; vacation; grounds; rehearing.

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration -

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly

executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

STATEMENT OF THE CASE

In October, 1985, respondent Nick DiMinico ("DiMinico"), a licensed representative and vice-president of respondent Shearson Lehman Hutton, Inc. (hereinafter "Shearson"), solicited petitioners to open a securities trading account with Shearson. Petitioners executed Shearson's standard form Client's Agreement.

Paragraph 13 of the Client's Agreement provided, in relevant part:

This agreement ... shall be governed by the laws of the State of New York. Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to

> transactions with you, your officers, directors, agents and/or employees for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Board of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc. as I may elect....[2]

DiMinico serviced petitioners' account and, during the course of his handling of the account, engaged in various forms of misconduct, including unauthorized trading and churning. In 1987, after incurring substantial losses, petitioners closed their account.

In January, 1989, petitioners filed suit in the United States District Court for the Northern District of Illinois, alleging that Shearson and DiMinico (hereinafter collectively "respondents")

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[2] The complete text of Paragraph 13 of the Client's Agreement is set forth at App. 44.

had subjected their account to unauthorized trading, churning and margin exposure. In their complaint, petitioners stated federal claims and state statutory and tort claims, with a prayer for punitive damages on the state claims. Jurisdiction of the District Court was invoked pursuant to 28 U.S.C. §1331 (federal question), with the District Court exercising original jurisdiction over petitioners' Securities Exchange Act claims and pendent (supplemental) jurisdiction over petitioners' state law claims.

In April, 1989, respondents moved, pursuant to the Federal Arbitration Act (hereinafter "FAA"), to compel arbitration before the National Association of Securities Dealers (hereinafter "NASD"). The District Court granted the motion.

Petitioners filed an amended complaint in arbitration, alleging violations of the NASD Rules of Fair Practice, SEC Rule 10b-5, §15-1 of the Securities Exchange Act, the Illinois Consumer Fraud Act, the Texas Deceptive Trade Practices-Consumer Protection Act, breach of fiduciary duty and negligence, with a request for punitive damages under the state law claims.

After the close of proofs in hearings conducted before a panel of three arbitrators, respondents submitted and the panel accepted respondents' Memorandum Regarding Claim For Punitive Damages and petitioners were given leave to file a reply. In their Memorandum respondents asserted, for the first time, that the arbitrators had no authority to award punitive damages.

The arbitrators awarded petitioners compensatory damages in the amount of $159,327.00 and punitive damages in the amount of $400,000.00.[3]

Respondents paid the compensatory damages award but moved in the District Court, pursuant to 9 U.S.C. §10(a)(4), to vacate the award of punitive damages. Respondents argued that New York law, the law governing the Client's Agreement, prohibits arbitrators from awarding punitive damages. Petitioners moved for confirmation of the arbitration award or,

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[3] Significantly, the NASD Arbitrator's Manual addresses the issue of punitive damages and provides that "[p]arties to an arbitration are informed that arbitrators can consider punitive damages as a remedy." Further, the NASD Rules of Fair Practice provide that "no agreement shall include any condition which ... limits the ability of arbitrators to make *any* award." [Emphasis added.] *Mastrobuono v. Shearson, Lehman, Hutton, Inc.*, 20 F. 3d 713, 717-718; App. at 15-17.

in the alternative, for a trial on their punitive damages claims. The District Court granted respondents' motion, vacating the punitive damages award, and denied petitioners' motion in its entirety.

On appeal, the Seventh Circuit affirmed the decision of the District Court, confirming the District Court's finding that the arbitrators had exceeded their power by awarding punitive damages.

REASONS FOR ALLOWANCE OF THE WRIT

This case presents significant issues relating to the enforcement of arbitration agreements pursuant to the Federal Arbitration Act (9 U.S.C. §1, *et seq.*) (hereinafter "FAA") and in accordance with "the liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural

policies to the contrary." *Moses H. Cone Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983).

In this case, the Seventh Circuit determined that a choice of law provision could be construed to defeat the clear intentions of the parties to arbitrate "any controversy arising out of or relating to [the petitioners'] accounts," and, in that guise, to resurrect the "judiciary's longstanding refusal to enforce agreements to arbitrate," which the FAA was specifically enacted to defeat. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-220, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985); *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 474, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989).

Significantly, the decision of the Seventh Circuit in this case reflects a clear and ever-widening split of authority among the Circuit Courts of Appeal on the precise issue presented. Consistent with the provisions of the FAA and the policies embodied in that Act, the First, Eighth, Ninth and Eleventh Circuits have ruled that a choice of law provision contained in an agreement which also contains a broad arbitration clause does not operate to preclude an arbitral award of punitive damages; the Second and Seventh Circuits have ruled to the contrary, relying on this Court's decision in *Volt, supra*.

This split of authority reflects diametrically opposed interpretations of the *Volt* decision. With regard to the issue presented, a plaintiff's ability to recover punitive damages in arbitration is

governed not by substantive legal considerations, but by the propriety of venue in a District Court of the First, Eighth, Ninth or Eleventh Circuits; if venue is proper only in a District Court of the Second or Seventh Circuits, a plaintiff may not enforce an arbitral award of punitive damages under identical circumstances. In other words, geographic fortuity, rather than a consistently applied rule of law, informed by legal analysis and equitable considerations, controls the arbitral remedies available to a plaintiff. Final binding resolution of the issue by this Court is the only way in which this manifestly unacceptable situation may be rectified.

In addition, absent review and reversal by this Court, the incorrect application by the Seventh Circuit (and

the Second Circuit) of the decision in *Volt* will serve to render the FAA a nullity as to any contract which contains a choice of law provision. In contravention of the express intentions of Congress in enacting the FAA, under the Seventh Circuit's erroneous construction of *Volt*, longstanding judicial prejudices against arbitration, as reflected in the decisions of the various states (*e.g.*, *Garrity v. Stuart*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976)), will be enforced under the pretense that, broad arbitration clauses notwithstanding, the parties intended to limit the power of the arbitrators by virtue of a choice of law clause. Accordingly, review by this Court is also necessary to clarify the appropriate application of the decision in *Volt*.

I. THE SEVENTH CIRCUIT'S INCORRECT DETERMINATION THAT THE LAW OF A STATE NAMED IN A CHOICE OF LAW PROVISION, RATHER THAN THE FAA, DETERMINES WHETHER AN ARBITRATOR HAS THE AUTHORITY TO AWARD PUNITIVE DAMAGES, CONFLICTS WITH THE DECISIONS OF THE FIRST, EIGHTH, NINTH AND ELEVENTH CIRCUITS ON THE SAME MATTER, CONTRAVENES THE POLICIES UNDERLYING THE FAA AND MISAPPLIES THE DECISIONS OF THIS COURT.

A. The Seventh Circuit's Decision In This Case Directly Conflicts With The Decisions Of The First, Eighth, Ninth And Eleventh Circuits And Deepens The Split Of Authority Among The Circuits On The Issue Presented.

In this case, in reaching its decision that the arbitration panel lacked authority to award punitive damages, the Seventh Circuit relied upon the inclusion in the Client's Agreement of a New York choice of law provision and the fact that, under New York state law, arbitrators are precluded from awarding punitive damages. (*Garrity v. Stuart*, 40 N.Y.2d 354, 386

N.Y.S.2d 831, 353 N.E.2d 793 (1976)). Relying on this Court's decision in *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989),[4] the Seventh Circuit found

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[4] In *Volt*, the contract at issue contained a comprehensive arbitration clause and a choice of law provision which, under the facts presented, made clear that the agreement was to be governed by California law. In determining the applicability of California rules of arbitration, as set forth in the California Arbitration Act, this Court held that "application of the California [Arbitration] Act is not pre-empted by the Federal Arbitration Act ... in a case where the parties have agreed that their arbitration agreement will be governed by the law of California." *Volt*, 489 U.S. at 470. In reaching its decision, the Court stated that Section 4 of the FAA only confers the right to obtain an order directing arbitration to proceed in the manner provided for in the parties' agreement, and that the federal policy favoring arbitration was not offended by the California state court's interpretation of the choice of law provision as an indication of the parties' intent that the California rules of arbitration apply. *Volt*, 489 U.S. at 474-475. Finally, the Court concluded that enforcement of the agreement did not undermine the goals and policies of the FAA. *Volt*, 489 U.S. at 477-479.

that by including a New York choice of law provision, without excluding New York's arbitration rules, the parties had adopted the ruling in *Garrity* as "a binding rule." *Mastrobuono v. Shearson Lehman Hutton Inc.*, 20 F.3d at 717; App. at 12.

In *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117 (2nd Cir. 1991), the Second Circuit reached the same conclusion, using a similar analysis, in construing essentially the same contractual provision at issue here. (*See also, Fahnestock & Co., Inc., v. Waltman*, 935 F.2d 512 (2nd Cir. 1991)).

The decisions of the Seventh Circuit in this case and the Second Circuit in *Barbier* directly conflict with the decision of the First Circuit in *Raytheon*

Co. v. Automated Business Systems, Inc., 882 F.2d 6 (1st Cir. 1989); the Eighth Circuit in *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993), *cert. denied*, __ U.S. __, 114 S.Ct. 287, 126 L.Ed.2d 237 (1993); the Ninth Circuit in *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991); and the Eleventh Circuit in *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988).

In *Raytheon*, the First Circuit affirmed an arbitral award of punitive damages finding that the parties had agreed to submit all disputes arising out of their exclusive dealership contract to arbitration conducted according to the rules of the American Arbitration Association (hereinafter "AAA"). The First Circuit acknowledged that "the broad policies of the Federal Arbitration Act"

governed its analysis and that the FAA expresses a strong federal policy in favor of arbitration. *Raytheon*, 882 F.2d at 9. Using these considerations as the general context for its inquiry, the court further considered the fact that the arbitration clause contained in the parties' contract was "neither limited in its scope nor optional in its application" and the fact that it required arbitration to be conducted pursuant to the rules of the AAA, which "'grant any remedy or relief which is just and equitable and within the terms of the agreement of the parties.'" *Raytheon*, 882 F.2d at 9-10. In light of the generous construction which this Court has indicated should be accorded agreements to arbitrate (*Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S.

614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985)), the First Circuit concluded:

> [I]t would seem sensible to interpret the "all disputes" and "any remedy or relief" phrases to indicate, at a minimum, an intention to resolve through arbitration any dispute that would otherwise be settled in a court, and to allow the chosen dispute resolvers to award the same varieties of relief as a court would be empowered to award. *Raytheon*, 882 F.2d at 10.

Further, the court noted and approved of the decisions of other jurisdictions which had held that a contract's choice-of-law provision does not require a reviewing court to determine whether arbitrators are empowered to award punitive damages by looking to the law of the chosen forum.

Although the First Circuit noted this Court's decision in *Volt*, it found that the *Volt* decision did not alter its

conclusions, distinguishing *Volt* on the basis that it involved the application of state procedural rules relating to arbitration, not the construction of the scope of an arbitration agreement.

Similarly, in *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993), *cert. denied*, ___ U.S. ____, 114 S.Ct. 287, 126 L.Ed.2d 237 (1993), the Eighth Circuit affirmed an arbitral award of punitive damages in a dispute arising out of a brokerage customer agreement. On appeal, the Eighth Circuit framed the issue before it as "whether federal or state law applies in interpreting the arbitration clause in the agreement and in determining if arbitrators can award punitive damages." *Lee*, 983 F.2d at 885. The Eighth Circuit rejected the line of reasoning applied by the Seventh Circuit in this case, ruling

that federal law, not state law, governed the issue. The court further noted that the parties had agreed that any arbitration would be conducted in accordance with the rules of the AAA, that the rules of the AAA permitted awards of punitive damages, and that the FAA gives force to the rules of the AAA. *See Lee*, 983 F.2d at 887-888.

In *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991), the Ninth Circuit affirmed an arbitral award of $1 million, rejecting the defendant's assertion that a New York choice of law provision contained in the parties' contract precluded an arbitration award of punitive damages. In this respect, the Ninth Circuit held that federal law, rather than New York state law, controlled, and that federal law

permitted arbitral awards of punitive damages. *Todd*, 943 F.2d at 1062-1063.

In reaching its decision, the Eleventh Circuit distinguished this Court's decision in *Volt*, finding that the Court "merely said that it would not disturb a state court's factual determination that the parties to the contract in *Volt* intended to invoke California arbitration rules." *Todd*, 943 F.2d at 1062, citing *Volt*, 109 S.Ct. at 1255.

In *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988), the defendant argued that a panel of arbitrators lacked power under a brokerage customer agreement, containing a New York choice of law provision, to award punitive damages. The customer agreement at issue also contained a broadly worded

arbitration clause and provided that arbitration was to be held in accordance with the rules of the Arbitration Committee of the Chamber of Commerce of the State of New York, the American Arbitration Association or the Board of Arbitration of the New York Stock Exchange, as selected by the plaintiffs. Relying on its earlier decision in *Willoughby Roofing & Supply Co. v. Kajima International, Inc.*, 598 F.Supp. 353, *affirmed*, 776 F.2d 269 (11th Cir. 1985), as well as this Court's decision in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), the Eleventh Circuit concluded that any doubts concerning the scope of arbitrable issues were to be resolved in favor of arbitration and that the arbitrators

could, upon remand, award punitive damages if they found that the facts warranted such an award.[5] The court reaffirmed the conclusions reached in *Willoughby*, stating:

> [A] choice of law provision in a contract governed by the Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages. *Bonar*, 835 F.2d at 1387, citing *Willoughby*, 598 F.Supp. at 359.

In this case, although the Seventh Circuit noted these decisions, it rejected them, stating, "Unlike the First, Eighth, Ninth and Eleventh Circuits, we draw a distinction between the scope of

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[5] Based on false testimony given in the arbitration by plaintiffs' expert, the court determined that remandment was necessary.

arbitrable issues and the availability of punitive remedies." *Mastrobuono,* 20 F.3d at 718; App. 19-20. Contrary to the Seventh Circuit's ruling, however, the authority of arbitrators to award punitive damages or to otherwise determine the claims for relief between the contracting parties, and to fashion an appropriate remedy, clearly presents a question relating to the scope of arbitrable issues, not the procedural rules governing arbitration. In fact, as discussed *infra*, in *Garrity*, in ruling that arbitrators could not award punitive damages, the New York Court did not address the issue as a question of procedure. To the contrary, the court expressed the issue as a question of the scope of an arbitrator's power and the ability of contracting parties to define the scope of an

arbitrator's authority, versus the realm of exclusive judicial authority. With regard to contracts evidencing transactions involving commerce, such an issue is clearly governed by the FAA. As this Court in *Volt*, reiterated:

> In recognition of Congress' principal purpose of ensuring that private arbitration agreements are enforced according to their terms, we have held that the FAA pre-empts state laws which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Volt*, 489 U.S. at 478-479. [Citations omitted.]

Finally, even if the power of arbitrators could be characterized as a procedural question, under this view, the contract is ambiguous because it incorporates both the New York "rule" against arbitral awards of punitive damages and "the rules then in effect, of

the National Association of Securities Dealers," under which punitive damages may be awarded. In accordance with federal policy, any such ambiguity should have been determined in favor of arbitration.

B. The Seventh Circuit's Decision In This Case Contravenes The Provisions Of The FAA And The Policies Underlying That Act.

In reaching its decision in this case, the Seventh Circuit concluded that the state law of New York, as set forth in *Garrity v. Stuart*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976), rather than the FAA, controlled the issue of petitioners' ability to recover punitive damages in arbitration. The decision in *Garrity*, which both the Seventh Circuit in this case and the Second Circuit in *Barbier* found controlling, exemplifies both the refusal to enforce agreements into which parties

have entered and the antiquated jealousy with which the judiciary has traditionally regarded arbitrators and which Congress sought to obviate through enactment of the FAA. (*See Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-220, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985)). In *Garrity*, a split New York Court of Appeals concluded that an arbitrator has no power to award punitive damages even if the parties had agreed to such an award.[6] *Garrity*, 40 N.Y.2d at 356, 359-360. In reaching its decision, the New York court held that punitive damages is a sanction reserved to the State and that enforcement of an arbitral award of punitive damages

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[6] Three justices concurred in the majority opinion, written by Chief Judge Breitel, with two justices concurring in the dissent written by Judge Babrielli.

would violate strong public policy. *Garrity*, 40 N.Y.2d at 357.

Numerous passages in the *Garrity* decision illustrate the judicial disdain for arbitration which the FAA was intended to overcome. For example, in *Garrity*, the New York court held:

> It is also true that arbitrators generally are free to fashion the remedy appropriate to the wrong, if they find one, but an authentic remedy is compensatory and measured by the harm caused and how it may be corrected. These broad principles are tolerable so long as arbitrators are not thereby empowered to ride roughshod over strong policies in the law which control coercive private conduct and confine to the State and its courts the infliction of punitive sanctions on wrongdoers. *Garrity*, 40 N.Y.2d at 357. [Citations omitted.]

The court further stated:

> Even if the so-called "malicious" breach here involved would permit of the imposition of punitive damages by a court or jury, it was not the province

> of arbitrators to do so. Punitive sanctions are reserved to the State, surely a public policy "of such magnitude as to call for judicial intrusion." The evil of permitting an arbitrator whose selection is often restricted or manipulatable by the party in a superior bargaining position, to award punitive damages is that it displaces the court and the jury and therefore the State, as the engine for imposing a social sanction. *Garrity*, 40 N.Y.2d at 358. [Citations omitted.]

The decision of the Seventh Circuit in this case serves to enforce such discredited and contemptuous views of arbitration, in contravention of the FAA, by incorporating state court precedent relating to the arbitrability of claims into all arbitration agreements containing a choice of law provision. Absent reversal by this Court, the reasoning adopted by the Seventh Circuit (and the Second Circuit), will effectively permit the preemption of the FAA by state law by

means of "back door" choice of law clauses.

II. THE SEVENTH CIRCUIT INCORRECTLY RULED THAT, BY AGREEING TO A COMPREHENSIVE ARBITRATION CLAUSE AND TO THE SELECTION OF A FORUM IN A CHOICE OF LAW CLAUSE WHICH DOES NOT PERMIT PUNITIVE DAMAGES, PETITIONERS WAIVED THEIR RIGHTS TO RECOVER PUNITIVE DAMAGES.

In reaching its decision in this case the Seventh Circuit concluded not only that petitioners' punitive damages claims were not arbitrable but also that petitioners had waived any right to recover punitive damages because, "[u]nder the plain language of the agreement, the [petitioners] are entitled only to the damages available in arbitration under New York law." *Mastrobuono,* 20 F.3d at 718. Accordingly, the court ruled that, by agreeing to both a comprehensive arbitration clause and a New York choice of law provision, petitioners had

implicitly waived any right to recover punitive damages, regardless of the forum, and were not entitled to proceed in the District Court on their punitive damages claims. This ruling, however, clearly conflicts with the decisions of this Court which have defined a waiver as a voluntary and intentional relinquishment of a known right (*see e.g., Johnson v. Zerbst,* 304 U.S. 458, 464, 58 S.Ct. 1019, 82 L.Ed. 1461 (1938)), as well as the Eleventh Circuit's decision in *Bonar v. Dean Witter Reynolds, Inc.,* 835 F.2d 1378, 1387-1388 (11th Cir. 1988), which refused to find a waiver under circumstances essentially identical to those presented here.[7]

Moreover, the decision of the Seventh Circuit undermines the efficacy of arbitration as a means of alternative

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[7] See *supra,* pp. 23-25.

dispute resolution; under the Seventh Circuit's decision, comprehensive arbitration clauses have become traps for the unwary. According to the rationale adopted by the Seventh Circuit, by agreeing to an arbitration clause and a choice of law provision, parties to a contract have automatically agreed to waive any claims which, through a misguided scorn for arbitration, the courts of the chosen forum may have imposed on arbitrators in that forum. For this reason, as well as the reasons discussed above, the decision of the Seventh Circuit in this case must be reversed if arbitration is to remain a viable and desirable means of resolving disputes.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 93-1581

ANTONIO C. MASTROBUONO and
DIANA G. MASTROBUONO,

Plaintiffs-Appellants,

v.

SHEARSON LEHMAN HUTTON INC., a
corporation, NICK DIMINICO,
RICHARD F. BENZER, and
MARK STEVENSON,

Defendants-Appellees.

Argued October 26, 1993
March 30, 1994, Decided

Before BAUER AND COFFEY, *Circuit Judges*

and SKINNER, *District Judge*.[1]

Skinner, District Judge.

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[1] Hon. Walter Jay Skinner of the District of Massachusetts, sitting by designation.

An arbitration panel awarded $400,000 in punitive damages to the customers of a brokerage firm on their claims of unauthorized trading, churning, and margin exposure. The district court vacated the award because New York law, the governing law chosen by the parties, does not permit arbitrators to award punitive damages. We affirm.

In October 1985, the plaintiffs-appellants, Antonio and Diana Mastrobuono ("plaintiffs"), opened a brokerage account with Shearson Lehman Hutton, Inc. ("Shearson"). The plaintiffs are Illinois residents. Nick DiMinico, a vice president and licensed representative of Shearson in its Houston, Texas office, solicited and serviced the plaintiffs' account. Although Shearson's principal place of business is in New York, the most

significant contacts in this case were with Illinois.

Paragraph 13 of the Client Agreement between plaintiffs and Shearson provides:

> This agreement...shall be governed by the laws of the State of New York...[A]ny controversy arising out of or relating to [the plaintiffs'] accounts...shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Board of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc. as [the plaintiffs] may elect...

In January 1989, the plaintiffs filed suit in the United States District Court for the Northern District of Illinois, claiming that the defendants had subjected their account to unauthorized trading, churning, and margin exposure. Plaintiffs stated federal claims and state statutory and tort claims; they requested punitive damages on the state claims. In April

1989, Shearson moved to compel arbitration before the National Association of Securities Dealers ("NASD"). The district court granted the motion.

The plaintiffs filed an amended complaint in arbitration, alleging violations of the NASD Rules of Fair Practice, SEC Rule 10b-5, § 15-1 of the Securities Exchange Act, the Illinois Consumer Fraud Act, the Texas Deceptive Trade Practices-Consumer Protection Act, breach of fiduciary duty and negligence. The plaintiffs again sought punitive damages under the state law claims, including treble and punitive damages under the Texas statute. Hearings on all of the claims were held in Chicago, Illinois on August 11-12 and September 29, 1992 before a panel of three arbitrators. On the last day of the hearings, after the

close of proofs, Shearson submitted a Memorandum Regarding Claim for Punitive Damages, arguing that the panel had no authority to award punitive damages. The panel accepted the filing and permitted plaintiffs to file a reply memorandum.

The panel awarded the plaintiffs $115,274.00 for commissions and $44,053.00 for margin interest "as satisfaction for their claims." Shearson has paid the compensatory damages portion of the award. The panel also awarded $400,000 in punitive damages. Shearson filed a motion in the district court to vacate the award of punitive damages because New York law, the governing law of the Client Agreement, precludes an arbitral award of punitive damages. The plaintiffs moved to confirm the award, or in the alternative for a trial on the amount of punitive damages to

be awarded, or as a further alternative for a trial on the punitive damages claims.

The district court denied the plaintiffs' motion and vacated the award of punitive damages under § 10(a)(4) of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 10(a)(4). 812 F.Supp. 845 (N.D.Ill. 1993). The court held that the plaintiffs had "contractually waived any potential award of punitive damages in arbitration," *id.* at 846, and that the arbitrators exceeded their power by making the award. The court denied the motion to sever the punitive damages claims for trial because punitive damages were precluded by the arbitration agreement, and because neither Illinois nor New York law permits a separate cause of action

solely for punitive damages. This appeal followed.

SHEARSON'S WAIVER

The plaintiffs argue that Shearson waived its objections to the claim for punitive damages by not raising the issue until the proofs in arbitration had closed. We disagree. The plaintiffs had an opportunity to respond to Shearson's late submission, and they certainly were not prejudiced in any way. The arbitrators and the district court had the opportunity to consider the arguments of both parties.

DISCUSSION

I. Scope of review

We first address plaintiffs' argument that the district court violated the standard of review imposed by the Federal Arbitration Act. In relevant part,

§10(a)(4) of the FAA permits a court to vacate an award "[w]here the arbitrators exceeded their powers." The arbitrator's errors of law and contract construction are normally unreviewable under this standard. *Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 F.2d 1501 (7th Cir. 1991). However, our narrow scope of review does not immunize an award clearly unauthorized by the terms of the agreement. *See Miller Brewing Co. v. Brewery Workers Local Union No. 9*, 739 F.2d 1159, 1164 (7th Cir. 1984), *cert. denied*, 469 U.S. 1160, 105 S.Ct. 912, 83 L.Ed.2d 926 (1985) (court may reverse award that "clearly" was not "within the contemplation of the parties and...implicitly authorized by the agreement"). As the Court of Appeals for the Second Circuit has observed, where the

arbitrators are not entitled to award punitive damages due to a choice of law provision in the parties' agreement, it is "manifest" that the arbitrators would exceed their powers by awarding punitive damages. *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117, 122 (2d Cir. 1991). "[T]here is no clearer case of a case falling...within" § 10(a)(4) of the Act. *Id.* The district court properly reviewed the panel's authority to award punitive damages.

II. Enforcement of the arbitration agreement

The FAA created "a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32, 103 S.Ct. 927, 942 n. 32, 74 L.Ed.2d 765 (1983). Because there is a "liberal

federal policy favoring arbitration agreements," *id.* at 24, 103 S.Ct. at 941, courts should "liberally construe the scope of arbitration agreements." *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627, 105 S.Ct. 3346, 3354, 87 L.Ed.2d 444 (1985). Doubts concerning "the scope of arbitrable issues" should be resolved in favor of arbitration. *Moses H. Cone*, 460 U.S. at 24-25, 103 S.Ct. at 941-42. However, the federal policy "is simply to ensure the enforceability, *according to their terms*, of private agreements to arbitrate." *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468, 476, 109 S.Ct. 1248, 1254, 103 L.Ed.2d 488 (1989) (emphasis added). We may not rewrite the agreement to enhance

arbitrability or otherwise expand the scope of the arbitrator's powers.

Under New York law, the governing law of the agreement, arbitrators may not award punitive damages. *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 831-32, 353 N.E.2d 793, 794 (1976). The plaintiffs argue at length that the Garrity rule as applied to the agreement is preempted by the FAA. Preemption becomes an issue only if the parties intended to arbitrate on terms foreclosed by applicable state law:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting courts to "rigorously enforce" such agreements according to their terms...we give effect to the contractual rights and

> expectations of the parties, without doing violence to the policies behind the FAA.

Volt, 489 U.S. at 479, 109 S.Ct. at 1256. Here the parties agreed to arbitrate all of their controversies under New York law. By choosing New York law without excluding its arbitration rules, the parties adopted *Garrity* as a binding rule.

In *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984), we examined a brokerage agreement that also compelled arbitration of all controversies under New York law. Although the plaintiffs in *Pierson* may not have realized that "the plain wording of their arbitration clause" precluded any award of punitive damages, we held that "the Piersons cannot use their failure to inquire about the ramifications of that

clause to avoid the consequences of agreed-to arbitration." *Id.* at 338-39.

Notwithstanding *Pierson*, the plaintiffs argue that the *Garrity* rule is inapplicable here because the agreement does not expressly bar punitive damages. Paragraph 13 of the agreement provides that "any controversy arising out of or relating to" the plaintiffs' account "shall be settled by arbitration." According to the plaintiffs, a demand for punitive damages is a "controversy" which, in the absence of an express exclusion from a broad arbitration clause, must be submitted to arbitration.

We do not think the *Garrity* rule can be characterized as a specific exclusion from the arbitration agreement. Submission to New York law is a general condition upon the arbitration of all

"controvers[ies]" between the parties. Because any condition imposed by New York law can be found in the books, a choice of law provision suffices to incorporate the *Garrity* rule. By contrast, specific exclusions must be stated in the arbitration agreement because they cannot be gleaned from another source.

In *Pierson*, we did not address the argument that some other provision of the agreement authorized punitive damages, *contra* the choice of New York law. The plaintiffs argue that the arbitration rules of the NASD incorporated by reference in ¶ 13 of the agreement, expressly authorize arbitrators to award punitive damages.

The NASD Code of Arbitration Procedures is "prescribed and adopted...for the arbitration of any

dispute, claim or controversy" connected with the business of an NASD member. § 1. Section 41(e) of the Code states that the arbitral award "shall contain...a summary of...the damages and other relief awarded." Neither of these procedural provisions confers a substantive right to a particular type of damages. *Cf. Fahnestock & Co., Inc. v. Waltman*, 935 F.2d 512, 518 (2d Cir. 1991) (the *Garrity* rule is a rule of state substantive law).

Unlike the Code of Arbitration Procedures, the NASD Arbitrator's Manual specifically addresses punitive damages:

> B. Punitive Damages
>
> The issue of punitive damages may arise with great frequency in arbitrations. Parties to arbitration are informed that arbitrators can consider punitive damages as a remedy.

We do not think that this provision of the Manual authorizes an award of punitive

damages in derogation of the governing law of the agreement. New York law applies no matter which set of arbitral rules the plaintiffs happen to choose. The Court of Appeals for the Second Circuit has held that the arbitration rules of the New York Stock Exchange -- which were also available to the plaintiffs -- do not empower arbitrators to award punitive damages. *Fahnestock*, 935 F.2d at 519. We do not think the parties intended the availability of punitive damages to vary with the plaintiffs' choice of arbitration rules. The more sensible construction of the agreement is that the *Garrity* rule always controls, whether the plaintiffs choose NASD, NYSE, or American Stock Exchange rules.

For the same reasons, the NASD Rules of Fair Practice do not override the

parties' choice of New York law. Section 21(f)(4) of the Rules provides that "[n]o agreement shall include any condition which...limits the ability of the arbitrators to make *any* award" (emphasis added). To the extent that this provision conflicts with New York law, the governing law of the agreement under all circumstances, we must conclude that the parties intended to be bound by New York law.

The plaintiffs urge us to resolve any conflict between NASD rules and New York law in favor of the award of punitive damages. That is not quite what federal policy requires. Moses H. Cone, 460 U.S. at 24-25, 103 S.Ct. at 941-42, states that "any doubts concerning the *scope of arbitrable issues* should be resolved in favor of arbitration" (emphasis added).

The Client Agreement does not purport to withhold certain issues from arbitration. In fact, it refers all "controvers[ies]" to arbitration -- subject always to the strictures of New York law. We think the policy favoring arbitrability applies with less force when there are doubts concerning the availability of punitive remedies - as opposed to the "scope of arbitrable issues." *Cf. Independent Employees' Union v. Hillshire Farm Co.*, 826 F.2d 530, 535 (7th Cir. 1987) ("[t]his court and other arbitrators have recognized that arbitral remedies, with few exceptions, may not be punitive"). Just as the FAA does not favor or disfavor arbitration under a given set of procedural rules, *Volt*, 489 U.S. at 476, 109 S.Ct. at 1254, neither does it favor or disfavor any particular type of

remedy. We construe the arbitration agreement liberally, as we must, but we need not automatically resolve all doubts so as to authorize punitive damages.

We recognize that some circuit courts have reached a different result. *See Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988); *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6 (1st Cir. 1989); *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991); *Lee v. Chica*, 983 F.2d 883 (8th Cir.), *cert. denied*, __ U.S. __, 114 S.Ct. 287, 126 L.Ed.2d 237 (1993). We prefer to follow the implications of our decisions in *Pierson* and *Hillshire Farm, supra*. Unlike the First, Eighth, Ninth, and Eleventh Circuits, we draw a distinction between the scope of arbitrable issues and the availability of

punitive remedies. We resolve any apparent conflict between New York law and the NASD rules in favor of New York law, the generally applicable law of the agreement. *Cf. Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117, 122 (2d Cir. 1991) (vacating arbitral award of punitive damages because "the parties elected to abide by 'the laws of the State of New York' in the event of a dispute under the Agreement").

Given our conclusion that the parties wished to arbitrate all of their disputes subject to *Garrity*, there is no need to consider whether the *Garrity* rule is preempted by the FAA or by the federal common law "govern[ing] the construction of arbitration agreements," *Raytheon*, 882 F.2d at 11 n.5. "Interpreting a choice-of-law clause to make applicable state

rules governing the conduct of arbitration...does not offend the rule of liberal construction set forth in *Moses H. Cone*, nor does it offend any other policy embodied in the FAA." *Volt*, 489 U.S. at 476, 109 S.Ct. at 1254. We also reject the plaintiffs' contention that the district court should at least have severed the punitive damages claims for trial. Under the plain language of the agreement, the plaintiffs are entitled only to the damages available in arbitration under New York law.

III. Conflict of laws

The plaintiffs argue that the choice of law provision includes all New York law, even its conflict of laws principles. According to the plaintiffs, the district court erred by not applying New York conflicts law, which would have "bounced"

the applicable law from New York back to Illinois. We disagree. In *Sarnoff v. American Home Products Corp.*, 798 F.2d 1075, 1080 (7th Cir. 1986), where the contract also specified New York law, we observed that a federal court sitting in diversity should apply the conflicts law of the forum state. We have also held that in federal question cases, "the choice-of-law rule for pendent state claims should be that of the forum." *Baltimore Orioles, Inc. v. Major League Baseball Players Ass'n*, 805 F.2d 663, 681 (7th Cir. 1986), *cert. denied*, 480 U.S. 941, 107 S.Ct. 1593, 94 L.Ed.2d 782 (1987). Applying New York conflicts law to the state claims here would "[re]introduce the uncertainties of choice of law" and "defeat the basic objectives, namely those of certainty and

predictability, which the choice-of-law provision was designed to achieve." Restatement (Second) of Conflict of Laws §187(3), comment h (1988).

Under Illinois conflicts law, we may enforce the parties' chosen law if it is not "dangerous, inconvenient, immoral, [or] contrary to the public policy" of Illinois. *McAllister v. Smith*, 17 Ill. 328, 333 (1856). The plaintiffs argue that the *Garrity* rule is contrary to Illinois public policy because Illinois permits arbitrators to award punitive damages. As we noted in *Sarnoff*, 798 F.2d at 1081, Illinois courts have enforced the parties' choice of foreign law even where that law is arguably inconsistent with an Illinois statute. "[T]he public policy considerations must be strong and of a *fundamental* nature to justify overriding

the chosen law of the parties." *Potomac Leasing Co. v. Chuck's Pub, Inc.*, 156 Ill.App.3d 755, 109 Ill.Dec. 90, 93, 509 N.E.2d 751, 754 (1987) (emphasis added). The Illinois cases raise no such "fundamental" policy considerations against the *Garrity* rule. In fact, Illinois appears to disfavor arbitral awards of punitive damages. *See Edward Elec. Co. v. Automation, Inc.*, 229 Ill.App.3d 89, 171 Ill.Dec. 13, 23, 593 N.E.2d 833, 843, *app. denied*, 146 Ill.2d 625, 176 Ill.Dec. 796, 602 N.E.2d 450 (1992) (punitive damages may not be awarded in arbitration unless "the parties have expressly agreed to the arbitrators' authority to award punitive damages").

In Illinois, "[a] second recognized limitation to an express choice of law provision is the requirement that there be

some relationship between the chosen [law] and the parties or the transaction." *Potomac Leasing*, 109 Ill.Dec. at 93, 509 N.E.2d at 754. Shearson has conceded that the most significant contacts in this case were outside New York. That fact might be decisive if there were no contractual choice of law provision. However, as we observed in *Sarnoff*, 798 F.2d at 1082, it is reasonable for a corporation with far-flung interests to bargain for the law of its headquarters state. New York law is reasonably related to the parties because Shearson's principal place of business is New York. *See Janice Doty Unlimited, Inc. v. Stoecker*, 697 F.Supp. 1016, 1019-20 (N.D.Ill. 1988); *ISC-Bunker Ramo Corp. v. Altech, Inc.*, 765 F.Supp. 1310, 1335-36 (N.D.Ill. 1990). The district court

correctly applied New York law as the governing law of the agreement.

IV. Predispute waiver of punitive damages

The plaintiffs argue that a predispute waiver of punitive damages is void under the public policies of Texas and Illinois. This argument was not raised in the district court. Accordingly, it has been waived on appeal. *See Resolution Trust Corp. v. Juergens*, 965 F.2d 149, 153 (7th Cir. 1992).

CONCLUSION

Federal policy "favor[s] arbitration agreements," *Moses H. Cone*, 460 U.S. at 24, 103 S.Ct. at 941, not "arbitration" *per se*. The plaintiffs-appellants cannot avoid their own choice of governing law. The district court's order vacating the award of punitive damages and denying the plaintiffs' motion in the alternative for

a trial on the punitive damage claims is *affirmed*. Costs shall be awarded to the appellees.

UNITED STATES DISTRICT COURT,
NORTHERN DISTRICT OF ILLINOIS,
EASTERN DIVISION

89 C 0773

ANTONIO C. MASTROBUONO and
DIANA G. MASTROBUONO,

Plaintiffs,

v.

SHEARSON LEHMAN HUTTON INC., a
corporation, NICK DIMINICO,
RICHARD F. BENZER, and
MARK STEVENSON,

Defendants.

February 9, 1993

ORDER

NORGLE, District Judge.

Before the court is the motion of defendants Shearson Lehman Hutton Inc. ("Shearson") and Nick DiMinico ("DiMinico") to partially vacate an

arbitration award. For the following reasons, the motion is granted.

FACTS

In October, 1985, the plaintiffs, Antonio C. Mastrobuono and Diana G. Mastrobuono (the "Mastrobuonos"), opened a brokerage account with Shearson. The Mastrobuonos' account was solicited by DiMinico, who was the registered representative servicing their account. Upon opening their account, the Mastrobuonos entered into a Client Agreement (the "Agreement") with Shearson. Paragraph 13 of the Agreement stated that any controversy relating to the Mastrobuonos' account would be settled by arbitration and would be governed by New York law.

In January, 1989, the Mastrobuonos filed a lawsuit against the defendants,

claiming that their account had been subjected to unauthorized trading, churning, and margin exposure. The Mastrobuonos' complaint contained both federal and state law claims, including requests for punitive damages on the latter. After having been ordered by this court to arbitrate their dispute pursuant to paragraph 13 of the Agreement, the Mastrobuonos commenced arbitration proceedings before the National Association of Securities Dealers, Inc. ("NASD").

Arbitration hearings were conducted in August and September, 1992. On October 13, 1992, the arbitration panel executed their award, awarding the Mastrobuonos the sum of $115,274 in commissions and $44,053 in margin interest "as satisfaction for their claims." The arbitrators also

assessed punitive damages against Shearson and DiMinico in the amount of $400,000. Shearson has paid the compensatory damages awarded by the arbitration panel; with regard to the punitive damages, however, Shearson and DiMinico challenge the arbitrators' authority to bestow such an award.

DISCUSSION

The agreement specifically provides in Paragraph 13 that: "[t]his agreement...shall be binding on the undersigned...and shall be governed by the laws of the State of New York..." As the Seventh Circuit has expressly found, a customer of a brokerage firm who signs an agreement expressly governed by New York law has contractually waived any potential award of punitive damages in arbitration. *Pierson v. Dean, Witter, Reynolds, Inc.*,

742 F.2d 334, 337-39 (7th Cir.1984) ("the plain wording of the arbitration clause [meant] losing the possibility of obtaining punitive damages"..."which are not permitted in arbitration under New York law..."); *see Baselski v. Paine, Webber, Jackson & Curtis, Inc.*, 514 F.Supp. 535, 543 (N.D.Ill.1981) (parties to an arbitration agreement governed by the law of the State of New York have contractually waived "right" to punitive damages); *see also Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117 (2d Cir.1991) (New York law prohibits award of punitive damages in arbitration); *Fahnestock & Co. v. Waltman*, 935 F.2d 512, 517 (2d Cir.), (same), *cert. denied*, ___ U.S. ___, 112 S.Ct. 380, 116 L.Ed.2d 331 (1991); *Melun Indust., Inc. v. Strange*, 1992 WL 8143 (S.D.N.Y. Jan. 10, 1992)

(same); *Shahmirzadi v. Smith Barney, Harris Upham & Co.*, 636 F.Supp. 49, 56 (D.D.C.1985) ("When the plaintiffs executed the Customer's Agreement, they contractually waived their right to punitive damages by agreeing to be governed by arbitration and New York law"); *Thomson McKinnon Securities v. Cucchiella*, 32 Mass.App.Ct. 698, 594 N.E.2d 870 (1992) (same).

The New York law that precludes arbitrators from awarding punitive damages is usually identified with the case of *Garrity v. Stuart*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976), which held that the imposition of punitive damages is a power reserved to the state and its courts. The Mastrobuonos argue that the Federal Arbitration Act, 9 U.S.C §1 *et seq*. (the "FAA"), which was designed

to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," *Dean Witter Reynolds, Inc. v. Byrd,* 470 U.S. 213, 219-220, 105 S.Ct. 1238, 1242, 84 L.Ed.2d 158 (1985), preempts application of *Garrity*. While the FAA does not contain an express preemptive provision, it has been held to preempt state laws that preclude parties from submitting matters to arbitration. *See Perry v. Thomas,* 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed.2d 426 (1987) (FAA preempted state law holding wage actions not arbitrable); *Southhand v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984) (FAA preempts state law precluding arbitration under state franchise act).

Although the FAA preempts state laws that require a judicial forum for the resolution of claims that contracting

parties have agreed to arbitrate, it does not create any independent rights to arbitrate. Accordingly, the Supreme Court found that enforcing an arbitration agreement's choice-of-law provision in accordance with the terms of that agreement is fully consistent with the goals of the FAA. *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 477, 109 S.Ct. 1248, 1255, 103 L.Ed.2d 488 (1989). In *Volt*, the Supreme Court found that the liberal policy favoring arbitration did not provide any basis for ignoring choice-of-law provisions in arbitration agreements:

> There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpreting a choice-of-law clause to make applicable state rules governing the conduct of

> arbitration--rules which are manifestly designed to encourage resort to the arbitral process--simply does not offend the rule of liberal construction...nor does it offend any other policy embodied in the FAA.

Id. at 476, 109 S.Ct. at 1254.

In *Barbier v. Shearson Lehman Hutton, Inc.*, the Second Circuit specifically addressed the very same Client Agreement at issue in this case and rejected the argument "that the *Garrity* rule conflicts with federal law and thus is preempted by the FAA." 948 F.2d 117,121 (1991). Based on the holding in *Volt*, the Second Circuit concluded that the choice-of-law provision of paragraph 13 was not preempted by federal law and that the application of the *Garrity* rule furthered the policy of the FAA by enforcing the terms of the parties' arbitration agreement: "[i]t is apparent from the inclusion of the choice-

of-law provision that the parties intended to be bound by *Garrity*, and 'as with any other contract, the parties' intentions control'". *Id.* at 122 (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626, 105 S.Ct. 3346, 3354, 87 L.Ed.2d 444 (1985)).

In support of their federal preemption argument, the Mastrobuonos cite a trilogy of cases in which the Supreme Court rejected traditional judicial antipathy to arbitration and, based on the FAA, established the validity of arbitration as a means of resolving disputes. *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987); *Mitsubishi Motors*, 473 U.S. 614, 105 S.Ct. 3346; *Byrd*, 470 U.S. 213, 105 S.Ct. 1238. Based on these cases, the Mastrobuonos contend

that "the trend has been overwhelmingly to recognize that punitive damages are arbitrable." Whether punitive damages are arbitrable, however, is not an issue in the underlying dispute. Instead, at issue is whether punitive damages are an available remedy where an arbitration agreement is governed by New York law.

The *Volt* court found that, just as parties can limit the issues which they will arbitrate, so too may they specify the rules under which arbitration will be conducted. *Volt*, 489 U.S. at 477, 109 S.Ct. at 1255. Where the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA. Because the Mastrobuonos agreed to arbitrate their dispute in accordance with

laws of the State of New York, and because the Agreement does not explicitly or by incorporation authorize the award of punitive damages, the remedies available to them are limited by the *Garrity* rule. This limitation gives effect to the contractual rights and expectations of the parties and does not violate the policies codified in the FAA. Accordingly, the punitive damages awarded the Mastrobuonos are vacated pursuant to 9 U.S.C. § 10. *See First Commercial Fin. Group, Inc. V. Baghdoian*, 812 F.Supp. 837 (N.D.Ill. 1993) (discussing FAA grounds for vacating an arbitration award).

Subsequent to Shearson and DiMinico's motion to vacate, the Mastrobuonos filed a motion to confirm the arbitration award or, alternatively, to award punitive damages or set a date for trial on the

claims for which the imposition of punitive damages is usually allowed. As discussed above, the punitive damages award must be vacated in accordance with the terms of the Agreement's paragraph 13 and the *Garrity* rule; therefore, Mastrobuonos' motion to confirm must be denied.

In support of their request that this court award punitive damages, the Mastrobuonos contend that if New York law prohibits arbitrators from awarding punitive damages, the court could somehow retain jurisdiction over that remedy. By providing that New York law govern their agreement, the Mastrobuonos agreed that the damages available to them would be those awardable by arbitration under New York law. This was not a waiver by the defendants of their FAA-guaranteed right

to compel arbitration of this dispute, including the award of damages, *see* 9 U.S.C. § 4 (party has right to obtain an order directing that "arbitration proceed in the manner provided for in [the parties'] agreement"), but, instead, was the Mastrobuonos' waiver of their potential right to receive punitive damages. Accordingly, the court cannot, in disregard of the FAA, award damages that are precluded by the parties' privately negotiated arbitration agreement. *See Byrd*, 470 U.S. at 219, 105 S.Ct. at 1241.

Furthermore, as to whether the Mastrobuonos may separately litigate the remedy of punitive damages, both Illinois and New York law preclude a separate cause of action solely for punitive damages. *See Kemner v. Monsanto*, 217 Ill.App.3d

188, 199, 160 Ill.Dec. 192, 199, 576 N.E.2d 1146, 1153, *app. denied*, 142 Ill.2d 655, 164 Ill.Dec. 918, 584 N.E.2d 130 (1991) ("Illinois does not recognize a cause of action for punitive damages alone"); *McGrew v. Heinold Commodities, Inc.*, 147 Ill.App.3d 104, 110, 100 Ill.Dec. 446, 451, 497 N.E.2d 424, 429 (1986) ("Illinois, like most states, does not recognize a cause of action for punitive damages alone"); *Florsheim v. Travelers Indem. Co.*, 75 Ill.App.3d 298, 309-10, 30 Ill.Dec. 876, 886, 393 N.E.2d 1223, 1233 (1979) (same); *Waltman v. Fahnestock & Co.*, 792 F.Supp. 31, 33 (E.D.Pa.1992) (New York does not provide for a separate cause of action for punitive damages); *Santos v. Security & Law Enforcement Employees, Council 82*, 80 A.D.2d 554, 435 N.Y.S.2d 357, 358 (1981)

("[I]n this state there is no separate cause of action for punitive damages."). Accordingly, the Mastrobuonos' alternative motion to set a date for trial on their "pending claims for punitive damages" must be denied.

CONCLUSION

For the foregoing reasons, the motion of Shearson and DiMinico to vacate the Mastrobuonos' award of punitive damages is granted.

IT IS SO ORDERED.

Paragraph 13 of the Client's Agreement provides:

> This agreement shall inure to the benefit of your successors and assigns shall be binding on the undersigned, my heirs, executors, administrators and assigns, and shall be governed by the laws of the State of New York. Unless unenforceable due to federal or state law, any controversy arising out of or relating to [the petitioners'] accounts, to transactions with you, your officers, directors, agents and/or employees for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc. as I may elect. If I do not make such election by registered mail addressed to you at your main office within 5 days after demand by you that I make such election, then you may make such election. Judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction thereof. This agreement to arbitrate does not apply to future disputes arising under certain of the federal securities laws to the extent it has been determined as a matter of law that I cannot be compelled to arbitrate such claims.